GOVERNOR'S CONSUMER PROTECTION TASK FORCE

RING FENCING

This paper has two parts. Part one consists of a conceptual discussion of a consumer protection mechanism commonly referred to as ring fencing. The second part is the draft recommendations that the Governor's Consumer Energy Protection Task Force subcommittee on ring fencing has agreed upon and recommends that the GTF adopt.

Discussion:

The Governor's Consumer Energy Protection Task Force (GTF) was directed to address three main issues, one of which concerned the financial condition of NorthWestern (NWE):

> 2. The evaluation of current Montana laws and rules to determine whether they are sufficient to protect and support Montana consumers' interests in the event NorthWestern Energy's financial condition deteriorates further;

Since that time NWE has filed for bankruptcy and the GTF has evaluated whether Montana laws and rules are sufficient to protect energy consumers from the financial effects decisions of unregulated subsidiaries have on regulated utilities. After several presentations and discussions, the GTF has concluded that existing laws and rules regarding financial controls for regulated energy utilities may not be adequate to protect Montana consumers' energy interests and recommends ring fencing legislation and rules be adopted. Further, the GTF has developed specific ring fencing measures that the GTF believes should form the basis of legislation.

Ring fencing is a term used to describe various controls undertaken by utility commissions and legislatures to protect regulated investor-owned utilities from the impacts of riskier activities engaged in by their holding companies or unregulated affiliates. The goal of ring fencing, and the GTF's recommendations, is to provide greater stability in terms of cost and quality of service to consumers receiving service from regulated energy utilities in Montana.

On the national level, events which have led to the development of ring fencing protections include: the Enron bankruptcy; the Pacific Gas And Electric bankruptcy; the growing concern of regulators and investors regarding the unforeseen risk taken by energy holding companies associated

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with their unregulated activities (primarily merchant generation and marketing and trading); the accounting irregularities that have been revealed for several companies associated with marketing and trading operations; and the attempt in Congress to repeal the Public Utility Holding Company Act of 1935 (PUHCA) which governs the regulated utilities and their relationships with parent companies and non-regulated affiliates and proscribes activities in which public utility holding companies may engage.

In Montana, NWE's bankruptcy filing was not caused by its utility operations, but by its failed non-utility affiliates, including Expanets, Blue Dot, and Cornerstone Propane. Additionally, Energy West narrowly avoided bankruptcy after an unregulated affiliate was sued by PPL Montana for improper energy scheduling. To be effective, ring fencing must isolate the regulated utility from the financial risks that may be imposed by the actions of non-utility businesses of the company.

The GTF notes that there is an issue regarding whether the Public Service Commission (PSC) currently has sufficient authority to implement ring fencing. Furthermore, a concern has been raised that by legislatively specifying specific ring fencing authority, the PSC's general authority to regulate may be weakened or limited. While noting these concerns, the GTF believes that the interests of consumers will be better served by ensuring that the PSC has the explicit authority to implement ring fencing. This position is consistent with those of the PSC and the Montana Consumer Counsel.

One important component of ring fencing not addressed in the following recommendations is that of transfer authority, or the PSC's authority to review and approve transfers of utility assets. Transfer authority was omitted from the discussion because the GTF has already taken action on that issue, requesting that the Interim Legislative Committee on Electricity and Telecommunications (ETIC) develop legislation that would clarify the PSC's existing authority.

Definitions:

"Regulated energy utility" means a utility owning distribution facilities for distribution of electricity or natural gas to the public and subject to the regulation of the Public Service Commission.

"Affiliate Interest" means any person, corporation, partnership or other entity over which the utility, its parent corporation, or a subsidiary company within the overall corporate structure can exercise, directly or indirectly, a high degree of control.

"Affiliated Transaction" means a transfer or sale of assets, or a provision of goods or services between a utility's accounts and accounts, for non-regulated or other regulated activities, of an affiliate interest. It also relates to the aforementioned activities between accounts of the regulated and non-regulated segments of a single public utility. Affiliated transactions do not include the use of shared services, the assignment of corporate overhead, or any other services the cost of which can be allocated for ratemaking purposes.

Recommendations:

The GTF recommends that legislation be developed to clarify or create new authority for the Montana Public Service Commission to:

1. Require PSC approval for all affiliated transactions between a regulated energy utility and an affiliate interest. Affiliate interest business ventures shall not be funded or financed in any way that places the regulated energy utility's credit quality or utility property in jeopardy.

2. Require PSC approval for all dividend payments from a regulated energy utility to a corporate parent.

3. Require PSC approval for all inter-company loans or other extensions of credit or advances of working capital between a regulated energy utility and an affiliate interest.

4. Require PSC approval for use of proceeds in security issuances for which the assets of the regulated energy utility are pledged.

5. Require PSC approval for all external borrowings of a regulated energy utility with a term greater than 120 days.

6. Authorize the PSC to require that a regulated energy utility maintain a minimum level of equity in its capital structure, to be determined on a case-by-case basis. In the event a regulated energy utility's equity level falls below the PSC determined minimum level, the utility would be required to file, (e.g. within 30 days), an explanation of the decline in the level of equity and also its plan for correcting the decline in equity. If the plan is determined to be inadequate by the PSC, or the problem persists, the PSC is given the authority to order any of the following remedies until the minimum equity level is reestablished;

    a. Reduction of debt,
    b. Asset sales,
    c. Issuance of additional common stock, and
    d. Suspension of dividend payments.

7. Authorize the PSC to provide regulatory forebearance of any or all of the above authorities upon good cause

    a. A customer base of less than 1,000 customers residing in Montana is one basis for forebearance.

Additionally, the GTF recommends that implementing legislation include intent language clearly stating that by granting these authorities the Legislature is not restricting or weakening any of the PSC's existing statutory authority.